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Implementation of the United Nations New Agenda for the Development of Africa in the 1990s, including measures and recommendations agreed upon at its mid-term review

Implementation of the United Nations New Agenda for the Development of Africa in the 1990s

Progress report of the Secretary-General*

Addendum

Mobilization of additional resources for African development: a study on overall resource flows to Africa

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I. Introduction

1. The international community has long recognized the need for mobilization and effective deployment of additional financial resources in order for Africa to fill the savings and investment and foreign exchange gaps associated with the development needs and domestic resource base of the region so as to significantly reduce poverty and improve the living standards of the African population. Income levels in African countries, particularly south of the Sahara, are too low to generate the adequate levels of savings to mobilize domestic resources for the required level of investment. The savings gap has tended to further widen owing to outflows in the form of capital flight. At the same time, Africa has been marginalized from international private capital, including foreign direct investment (FDI), and portfolio and non-concessional flows, owing to its perceived risk. As a result, the task of filling investment resource gaps falls on official development assistance (ODA).

2. So far (in both the 1980s and 1990s), the expectations in terms of external resource mobilization have not materialized, and the inflows have been largely offset by outflows. For example, ODA to Africa has been falling (by about 24 per cent in real terms) since the 1990s and about 70 per cent of the ODA flows to sub-Saharan Africa were offset by terms-of-trade losses in the period 1970-1997. For the same period, Africa's loss of market shares in its exports represents a staggering annual income loss of $68 billion or 20 per cent of gross domestic product (GDP) in current prices. Commodities account for 80 per cent of Africa's export earnings, which have recorded a decline by 25 per cent from 1997 to 1999 owing to the fall in world commodity prices. Capital flight remains pervasive and the stock is estimated at about the size of Africa's external debt stock at the end of the 1990s (about $360 billion). In comparison with the end of the 1980s, the recent trend indicates a worsening of aggregate resource flows to Africa.

3. The paradox, however, is that the ODA and other external resource inflows are falling precisely when the need is greatest, and the improvement in the quality of governance and economic management is such that the productivity of one dollar of ODA is increasing. At the GDP growth rate of 3.0 per cent in 1999 or the average of 2.1 per cent for the decade of the 1990s, growth performance remains far below the 5 per cent required to prevent the number of absolutely poor people from increasing, or the 7 per cent growth rate required to halve poverty in the region by the year 2015. To achieve the 7 per cent growth rate would require additional investment resources of about 13 per cent of GDP per annum in Africa and almost 23 per cent for sub-Saharan Africa (see table 1).

4. Thus, the fundamental challenge facing Africa in the new millennium is the asymmetry between its growing needs and dwindling resources. Evidently, development finance is no longer business as usual; but a broad consensus is yet to emerge on the way forward. The present addendum provides a picture, using broad brush strokes, of the recent trends in resource flows as well as the ongoing debate on a more effective strategy to address Africa's financing crisis; and proposes a set of proposals for an effective resource mobilization strategy.

II. Development needs and domestic resource base

5. With a population of nearly 800 million and per capita income of $688 in 1998 (lower than the figure in 1980, which was $749), Africa remains the world's poorest region. Africa is the only region where poverty is projected to increase in the next decade. For example, it is estimated that a GDP growth rate of 5 per cent is required just to prevent the number of poor people from increasing and one of 7 per cent or more to halve poverty by 2015. However, the growth rate in 1999 was a mere 3 per cent and just 2.1 per cent for the entire decade of the 1990s. Thus, if the current trend persists, it would appear that the war against poverty and underdevelopment in Africa will be a long one.

6. To reverse the current trend requires enormous investment resources and improvement in their efficiency. Table 1 illustrates the magnitude of the resource requirements if Africa is to make any progress with poverty reduction. The data in table 1 highlight both the aggregate magnitudes of resource requirements and efficiency levels (the incremental capital-output ratio (ICOR)) and the subregional differentiation. The last column shows the investment gap (that is to say, the extra investment required to achieve the poverty-reducing growth rate).

Table 1
Required growth and investment rates to halve poverty in Africa by 2015

Subregion	*Required GDP growth rate (percentage)*	*Incremental capital-output ratio (ICOR)*	*Required investment rate (percentage)*	*Current investment rate (percentage)*	*Investment gap (extra investment required as percentage of GDP)*
North	5.60	3.8	21.3	24.2	[a]
West	7.61	4.8	36.5	17.6	18.9
Central	6.70	7.3	48.9	20.0	28.9
East	8.12	5.6	45.5	14.6	30.9
South	6.20	6.1	37.8	17.6	20.2
Africa (average)	6.79	5.0	33.0	20.5	12.5
Sub-Saharan Africa	7.16	5.8	40.0	17.4	22.6

Source: The Economic Commission for Africa (ECA), *Economic Report on Africa* (Addis Ababa, Ethiopia, 1999).
[a] Not applicable.

7. At current efficiency levels, sub-Saharan African countries would require additional annual investment rates of 22.6 per cent to make a dent in poverty. In the long run and assuming East Asian efficiency levels, investment rates of at least 30 per cent of GDP per annum would still be required by sub-Saharan African countries. With the average savings rate at 13 per cent in the 1990s, sub-Saharan Africa faces a significant savings gap. Assuming that the region is able to attract up to 5 per cent of GDP in FDI and portfolio flows (the international norm that is considered the safe threshold), it would still experience a financial resource gap of about 12 per cent of GDP. This gap would need to be filled by additional mobilization of domestic savings and external financial resources.

8. Beyond growth and poverty reduction, additional resources are required to address a plethora of underdevelopment traps facing Africa. For example, the human

immunodeficiency virus/acquired immunodeficiency syndrome (HIV/AIDS) pandemic is ravaging Africa, especially sub-Saharan Africa. AIDS killed 2 million people in Africa in 1998 alone, leaving millions of children orphaned. Combating HIV/AIDS in a poor African country could cost 1-2 per cent of its GDP. Resources are also required to address the structural vulnerabilities of the region's economies, including production and export diversification, infrastructure development, regional security and the rehabilitation and reconstruction of war-ravaged economies. All of these factors mean that the resource requirements are far greater than the estimates, narrowly based on the required growth rate. How far have the trends in resource mobilization responded to the intensifying needs of African countries?

III. Domestic resource mobilization

9. In recent years, mobilization of government fiscal revenues in Africa has improved modestly and government de-saving through persistent deficits has been curtailed. Yet, these gains on the fiscal front have not translated into substantial increases in gross national savings rates (see table 2). With an average national saving of 15.8 per cent for the period 1996-1998, the rate is too small in comparison with Africa's historical peak performance of 28.4 per cent in 1980 or relative to requirements for growth. If the experience of the East Asian developing countries is any guide, a high savings rate of about 30 per cent is a prerequisite of rapid growth.

Table 2
Basic macroeconomic data, 1980-1998

	Sub-Saharan Africa (excluding Nigeria and South Africa)					*All Africa (Total)*				
	1980	*1990*	*1996*	*1997*	*1998*	*1980*	*1990*	*1996*	*1997*	*1998*
GNP per capita	403	408	314	324	320	749	709	690	704	688
Gross domestic investment, as percentage of GDP	18.1	16.0	20.2	19.6	19.3	22.3	18.8	18.8	18.8	19.6
Gross public investment, as percentage of GDP	..	5.9	6.2	6.0	6.1	..	7.5	5.9	6.1	6.3
Gross private financing, as percentage of GDP	..	9.0	12.1	12.8	12.3	..	12.1	12.1	12.6	13.1
Gross domestic saving, as percentage of GDP	20.4	15.0	13.3	14.4	13.3	31.8	19.3	18.2	17.9	16.2
Gross national saving, as percentage of GDP	16.4	11.6	10.0	11.4	10.7	28.4	17.4	16.1	16.3	14.9
Resource balance	-6.1	-3.1	-5.1	-5.1	-6.1	4.0	0.6	1.3	0.6	-2.2
Terms of trade	128.1	107.1	99.96	100.2	95.0	176.9	108.5	105.2	102.7	95.6
Foreign financing	..	4.2	3.8	1.2	1.7	..	1.0	1.2	0.4	0.3

Source: World Bank, *African Development Indicators, 2000* (Washington, D.C., 2000).
Note: Two dots (..) mean data unavailable.

10. Why is the savings rate so low in Africa? Three sets of factors can be proffered: the low savings base (subsistence income levels); weak institutional base for intermediation (thin, fragile, fragmented financial system with limited financial instruments); and de-capitalization. With very low per capita incomes and more than half the population in absolute poverty, economic activity is largely about the nuts and bolts of daily survival. Very little can be expected in terms of savings from households that are making a living at the fringe.

11. Given the very low income base and the atypical highest dependency ratio per worker in the world, the minuscule savings rate is not surprising. Also, the nature of poverty imposes another challenge: increased savings would require that consumption be squeezed. Paradoxically, for headcount poverty to be reduced, consumption would need to rise. So, there is clearly a limit to increasing domestic savings in Africa without jeopardizing the poverty reduction objective.

12. The low income base is not the only factor. After all, Africa saw domestic savings rate of over 30 per cent in 1980 (see table 2). There is also the issue of savings mobilization. For example, for the period 1967-1995, Benin and Kenya had exactly the same average per capita income of $344. Yet, while Kenya's average saving rate was 20 per cent, Benin's was a mere 2.9 per cent. Differences in savings mobilization could be due to the nature of the financial system, as well as the institutional and policy environment affecting intermediation (lower inflation, stronger growth, financial sector liberalization, and the legal framework for property rights and enforcement of contracts). Evidence shows a clear, strong relationship between the sophistication of financial infrastructure and the mobilization of savings.

13. Financial infrastructure in much of Africa is thin, fragmented and shallow, and it is not surprising that most African economies are hardly active participants in the global financial system. For example, the flow of net private capital to sub-Saharan Africa averaged 5 per cent of the total flows to all developing countries in 1998, and of this about 90 per cent of the flows went to the country with one of the most sophisticated financial systems outside the Organisation for Economic Cooperation and Development (OECD), namely, South Africa. The Johannesburg Stock Exchange is the tenth largest in the world. The other inflows of private portfolio capital went to the other dozen (albeit very small) emerging stock markets in sub-Saharan Africa — mostly to Abidjan, Accra, Lagos, Harare and Nairobi.

14. Capital markets as part of the financial system play a critical role in the provision of risk capital, lowering the cost of capital, spreading the risks associated with long-term investment projects, attracting venture capital funds (which could favour small-scale investments) and so forth. In the absence of capital markets, it is difficult to mobilize potential savings/investment by foreign and domestic financial institutions, institutional investors (such as pension funds, insurance companies and investment trusts) and individuals.

15. Capital markets also open up opportunities for profitable privatization and can be stimulated by privatization. They can improve risk management, and add an important dimension to corporate governance. Most African countries largely miss out on these benefits.

16. Financial transfers abroad also deplete domestic resources, and these transfers occur mainly at three levels. First, there are the budgetary transfers for debt-service

payments. Second, Africa transfers net resources abroad in the form of net factor income less public grants from abroad. This depletes domestic savings inasmuch as the aggregate national savings are much less than domestic savings. Third, there is capital flight which remains pervasive and severe.

17. Independent estimates reckon that for sub-Saharan African countries, private agents hold about 40 per cent of their total wealth abroad. At the end of the 1990s, the stock of capital flight was about the size of Africa's external debt or 90 per cent of GDP. A major structural feature of Africa's debt, therefore, is asset mismatch. The private sector has huge assets abroad while the public sector has responsibility for the liabilities — huge external debt. Furthermore, this trend is continuing, with a serious drain of potential investible resources.

18. Explanations for the capital flight are many but most of them boil down to risks associated with the safety and profitability of savings/investment. An aspect of the explanation that receives very little attention is the fact that capital flight is a symptom of a systemic problem — a highly volatile socio-economic environment, where economic agents have low expectations about the probability of a stable polity. Endemic poverty and ethnic conflicts, especially in the context of weak governance structures and weak enforcement of property rights (18 of 33 African least developed countries have already gone through civil wars), characterize countries with the highest capital flight.

IV. Trends in external resource flows

19. External finance remains the root of Africa's development finance. This source includes export receipts, and resource transfers from abroad — ODA including grants and loans (bilateral and multilateral, either concessional or non-concessional), FDI (equity); other private-portfolio investment (equity and debt); and private lending (short-term and medium- or long-term). Of these sources, ODA dominates aggregate flows to Africa (more than 80 per cent of total flows). Unfortunately, recent trends for all types of external sources at the end of the 1990s are worrisome: in terms of quantity, reliability and effectiveness, external finance has been disappointing.

20. Available data show that aggregate net resource flows to Africa declined from $26.0 billion in 1997 to $17.1 billion in 1998 (see table 3) or by more than one third. The 1999 data for sub-Saharan Africa show that there was some improvement in aggregate net resource flows over 1998 (from $15 billion in 1998 to $17.5 billion in 1999). However, the amount is still small relative to the development challenges facing African countries.

Table 3
Aggregate net resource flows to Africa, 1992-1999
(Billions of dollars)

	Period				
	1992	*1996*	*1997*	*1998*	*1999*
Sub-Saharan Africa					
ODA	15.7	11.1	11.9	9.83	11.4
Loans	4.2	0.84	2.03	-0.42	1.3
Grants	11.5	10.22	9.7	10.25	10.1
FDI	1.5	5.0	7.7	4.5	5.6
Portfolio investment	0	2.0	1.5	0.7	0.5
Subtotal	**17.2**	**18.1**	**21.1**	**15.0**	**17.5**
North Africa					
ODA	4.0	2.6	0.8	-0.18	[a]
Loans	1.2	0.78	-0.64	-2.04	[a]
Grants	2.8	1.8	1.43	1.86	[a]
FDI	1.4	1.2	2.32	2.1	[a]
Portfolio investment	0	1.5	2.06	0.17	[a]
Subtotal	**5.4**	**5.3**	**5.18**	**2.09**	[a]
Africa					
ODA	19.7	13.6	12.8	9.7	[a]
Loans	5.4	1.62	1.66	-2.46	[a]
Grants	14.3	12.02	11.13	12.11	[a]
FDI	2.9	6.2	9.6	6.6	[a]
Portfolio investment	0	3.5	3.6	0.87	[a]
Total[b]	**22.6**	**23.3**	**26.0**	**17.1**	[a]

Sources: World Bank, Global Development Finance, 2000: Analysis and Summary Tables (Washington, D.C., 2000); and World Bank, Global Development Finance, 2000: Country Tables (Washington, D.C., 2000).

[a] Data currently not available.

[b] The decimal points in the subtotal and total figures have been rounded to the nearest digit.

A. Official flows

21. External development finance has been secured mostly in the context of ODA and debt strategy (more than 80 per cent of total inflows). Since the 1990s, ODA has been falling in both nominal and real terms. For example, for Africa as a whole, ODA declined from $19.7 billion in 1992 to $9.7 billion in 1998; and for sub-Saharan Africa, from $15.7 billion in 1992 to $11.4 billion in 1999 (see table 3). Relative to promises and expectations, the fall has been very dramatic. For example, the World Bank had estimated in 1989 that sub-Saharan Africa's development challenges would require ODA to increase by 4 per cent per annum in real terms in

the 1990s. The reality was a 24 per cent decline in real terms for the 1990s, or an average annual decline between 1988 and 1999 of 2.4 per cent for sub-Saharan Africa and 3.4 per cent for North Africa.

22. In the period 1997-1998, only Denmark, the Netherlands, Norway and Sweden met or exceeded the United Nations target of 0.7 per cent of gross national product (GNP) for ODA (see tables 4 and 6). The United States of America has had the largest reduction in its aid budget (from 0.21 per cent of its GNP a decade earlier (1987-1988), to a mere 0.09 per cent in 1997-1998). The United States share of Development Assistance Committee (DAC) ODA fell from 30.3 per cent in 1977-1978 to 15.6 per cent in 1997-1998. Japan doubled its share of DAC/ODA from 10.7 per cent in 1977-1978 to 20 per cent in 1997-1998. However, as a share of Japan's GNP, Japan's ODA merely increased from 0.22 to 0.25 per cent for the above period (well below the target of 0.7 per cent).

23. Thus, the long-term trend in ODA flows as a percentage of DAC countries' GNP to all developing regions and to Africa in particular has been towards a precipitous decline (see tables 4, 5 and 6). Also, in respect of the least developed countries, the United Nations target for the OECD/DAC countries is the devoting of between 0.15 and 0.2 per cent of their GNP to assisting these poor countries. By 1996-1997, development assistance to these economies had fallen from 0.09 per cent of donors' GNP at the beginning of the decade to 0.05 per cent of donors' GNP (a fall of 29 per cent in dollar terms and 22 per cent in real terms). According to the United Nations Conference on Trade and Development (UNCTAD) *The Least Developed Countries: 1999 Report*,[1] "the 1990s have witnessed a fall in the GNP share of aid to least developed countries in 16 of the 21 DAC member countries, a rise in only 3, and stagnation in 2. Even the top four performers in meeting the 0.20 per cent ODA target for least developed countries have reduced the share of their GNP going to those countries".[2]

24. The aggregate decline in ODA, however, masks the individual country gains and losses. While most countries experienced average annual declines in their ODA receipts, a few African countries experienced an increase for the period 1988-1999 (see table 5). Algeria, Angola and the Democratic Republic of the Congo had the highest average annual growth of ODA for the period.

25. The fall in ODA in the OECD Governments' budget did not so much arise out of the lack of importance of aid resources as the lifeline for most African countries as stem from the changing motivation for development assistance. In reality, development is but one of the multiple objectives served by aid. With the end of the cold war, many African countries lost their strategic appeal (for example, the Sudan, Kenya and the Democratic Republic of the Congo (formerly Zaire)). Though this objective is not completely defunct, many of the recent debates on aid effectiveness focus on the developmental role of aid. The challenge is to redefine the role and delivery mechanism for aid in a post-cold war era and under the challenges of globalization.

Table 4

Long-term trends in Development Assistance Committee (DAC) official development assistance (ODA)

	Volume of net ODA (millions of United States dollars at 1997 prices and exchange rates)			*Two-year averages, net disbursements (ODA as a percentage of GNP)*		
	1977-1978	*1987-1988*	*1997-1998*	*1977-1978*	*1987-1988*	*1997-1998*
Australia	2.9	2.0	2.0	0.49	0.41	0.28
Austria	0.8	0.6	1.0	0.25	0.21	0.24
Belgium	2.7	1.5	1.6	0.51	0.44	0.33
Canada	6.0	4.8	3.7	0.51	0.48	0.32
Denmark	1.9	2.0	3.3	0.64	0.88	**0.98**
Finland	0.3	1.2	0.8	0.16	0.55	0.32
France	9.7	12.2	12.0	0.38	0.59	0.42
Germany	11.9	10.4	11.4	0.35	0.39	0.27
Ireland	0.1	0.1	0.4	0.15	0.20	0.30
Italy	1.7	6.6	3.5	0.12	0.37	0.15
Japan	10.7	18.8	20.0	0.22	0.31	0.25
Luxembourg	[a]	0.0	0.2	[a]	0.19	0.60
Netherlands	5.8	4.9	6.0	0.79	0.98	**0.80**
New Zealand	0.3	0.2	0.3	0.36	0.27	0.26
Norway	1.9	2.1	2.6	0.87	1.11	0.88
Portugal	[a]	0.1	0.5	[a]	0.16	0.25
Spain	[a]	0.5	2.6	[a]	0.08	0.24
Sweden	4.6	3.3	3.3	0.90	0.37	**0.75**
Switzerland	0.9	1.3	1.8	0.19	0.31	0.33
United Kingdom	7.6	5.2	7.3	0.45	0.30	0.27
United States	30.3	22.0	15.6	0.25	0.21	0.09
Total DAC	**100.0**	**100.0**	**100.0**	**0.32**	**0.33**	**0.23**
European Union (EU) members	47.0	48.8	54.0	0.40	0.44	0.33

Source: Organisation for Economic Cooperation and Development (OECD), *The DAC Journal of Development Cooperati .: 1999 Report* (Paris, 2000).

[a] Data unavailable.

Table 5
Total net receipts of ODA

	Percentage of total ODA					*ODA receipts*	
	1987-1988	*1992-1993*	*1997-1998*	*Percentage of DAC ODA, 1998*	*Share in total population, 1998 (percentage)*	*Billions of United States dollars, 1998*	*Annual real percentage change, 1988-1999*
North Africa	7.3	9.2	7.5	7.6	2.7	3.1	-3.5
Egypt	4.6	6.1	5.0	5.7	1.3	1.9	0.2
Morocco	1.3	1.7	1.3	1.0	0.6	0.5	-0.6
Algeria	0.6	0.8	0.8	0.5	0.6	0.4	6.1
Tunisia	0.8	0.6	0.4	0.4	0.2	0.1	-9.2
Sub-Saharan Africa	37.1	35.6	34.7	32.1	13.3	13.1	-2.4
Mozambique	2.3	2.7	2.6	2.8	0.4	1.0	-0.6
Tanzania, United Republic of	2.7	2.3	2.5	3.0	0.7	1.0	-1.7
Madagascar	0.9	0.7	1.7	1.3	0.3	0.5	3.1
Uganda	1.0	1.4	1.7	1.5	0.4	0.5	-0.5
Côte d'Ivoire	1.0	1.5	1.6	1.9	0.3	0.8	4.1
Ethiopia	2.3	2.3	1.6	1.4	1.3	0.6	-5.8
Ghana	1.4	1.2	1.5	1.5	0.4	0.7	0.1
South Africa	[a]	0.3	1.3	1.6	0.9	0.5	[a]
Zambia	1.3	1.9	1.2	1.0	0.2	0.3	-4.7
Senegal	1.8	1.2	1.2	1.1	0.2	0.5	-3.7
Cameroon	0.7	1.3	1.2	1.2	0.3	0.4	2.2
Kenya	2.0	1.8	1.2	1.1	0.6	0.5	-7.3
Mali	1.1	0.8	1.0	0.9	0.2	0.3	-4.1
Malawi	0.9	1.1	1.0	0.8	0.2	0.4	-0.6
Guinea	0.7	0.9	1.0	0.6	0.1	0.4	1.5
Angola	0.4	0.6	0.9	0.8	0.3	0.3	5.8
Niger	1.1	0.7	0.8	0.6	0.2	0.3	-4.5
Zimbabwe	0.8	1.3	0.8	0.8	0.2	0.3	-1.6
Rwanda	0.7	0.7	0.8	0.8	0.2	0.3	1.2
Democratic Republic of the Congo	0.3	0.2	0.4	0.2	0.1	0.1	4.9

Source: OECD, *The DAC Journal of Development Cooperation: 1999 Report* (Paris, 2000).
[a] Data unavailable.

Table 6
DAC countries' ODA/GNP to Africa

	1998		1997		
	ODA (millions of United States dollars)	*ODA GNP (percentage)*[a]	*ODA (millions of United States dollars)*	*ODA GNP (percentage)*[a]	*Real percentage change (1997-1998)*[b]
Australia	960	0.27	1 061	0.28	6.3
Austria	456	0.22	527	0.26	-13.3
Belgium	883	0.35	764	0.31	15.1
Canada	1 691	0.29	2 045	0.34	-11.0
Denmark	1 704	0.99	1 637	0.97	4.1
Finland	396	0.32	379	0.33	5.2
France	5 742	0.40	6 307	0.45	-8.7
Germany	5 581	0.26	5 857	0.28	-4.2
Ireland	199	0.30	187	0.31	8.6
Italy	2 278	0.20	1 266	0.11	78.4
Japan	10 640	0.28	9 358	0.22	22.6
Luxembourg	112	0.65	95	0.55	18.1
Netherlands	3 042	0.80	2 947	0.81	3.2
New Zealand	130	0.27	154	0.26	2.6
Norway	321	0.91	1 306	0.86	8.4
Portugal	259	0.24	250	0.25	2.7
Spain	1 376	0.24	1 234	0.24	11.2
Sweden	1 573	0.72	1 731	0.79	-6.2
Switzerland	898	0.32	911	0.34	-2.6
United Kingdom	3 864	0.27	3 433	0.26	8.6
United States	8 786	0.10	7 878	0.09	26.5
Total DAC	**51 888**	**0.24**	**48 324**	**0.22**	**9.6**
Average country effort		0.40		0.40	
Memo items:					
1. EU countries combined (included in above)	27 462	0.33	26 612	0.33	3.0
2. European Commission	5 140		5 261		-2.8

Source: OECD.

[a] DAC members are progressively introducing the new *System of National Accounts, 1993* (United Nations publication, Sales No. E.94.XVII.4). This is leading to slight upward revisions of GNP, and corresponding falls in reported ODA/GNP ratios.

[b] Taking account of both inflation and exchange rate movements.

26. The attempt to couch aid strictly in developmental terms has led to an emphasis on selectivity. Aid is believed to be more effective in countries with sound economic management. For the purpose of poverty reduction, it should go more to countries with lower per capita income (higher incidence of poverty). Evidence

shows that actual ODA allocation has not followed this pattern. On the contrary, even for poor countries with improved efforts in economic management, development assistance seems to be rapidly declining.

Changing composition and delivery mechanisms of ODA

27. It may be noted that not only is ODA falling, but its composition and delivery mechanism are also changing. Poverty reduction is now the fulcrum of new aid relationships. In 1999, the World Bank and the International Monetary Fund (IMF) emphasized poverty reduction as the central goal of development (the World Bank through the launching of its Comprehensive Development Framework (CDF) and IMF through the transformation of its Enhanced Structural Adjustment Facility (ESAF) into the Poverty Reduction and Growth Facility (PRGF) as well as the replacement of the contentious Policy Framework Paper (PFP) with the Poverty Reduction Strategy Paper (PRSP)).

28. The renewed emphasis is perhaps due to the failures of past efforts to stem the rise in poverty and in response to the international development goals to halve poverty by 2015. In the new "enhanced" Heavily Indebted Poor Countries (HIPC) Initiative, debt relief is conditioned on measurable efforts to reduce poverty (largely through increased spending on the social sector). As a consequence, assistance for the productive sectors and physical infrastructure would continue its declining trend, while the social, economic and administrative sectors continue to account for the bulk of the inflows. Foreign technical assistance, which currently absorbs over 25 per cent of ODA, is a major source of concern. More than 100,000 foreign experts in Africa costing about $4 billion per annum represent the leakage of aid resources.

29. Another major recent development is the rethinking of the aid delivery process. This is based on the realization that the current system constrains its effectiveness. It may be noted that aid comes through multiple, largely uncoordinated efforts of donors with different accounting standards and conditionality. According to the World Bank draft of the 2000 *World Development Report*, there were at one point 405 separate donor-funded projects in the Mozambican Ministry of Health alone. In the early 1990s, there were 40 donors and over 2,000 projects in the United Republic of Tanzania. In Ghana during the same period, there were 64 different government or quasi-government institutions receiving aid. The report concludes that it is nearly impossible, even at this sectoral level, to coordinate efforts of different agencies into a coherent development strategy.

30. Furthermore, bureaucratic capacity in Africa is weakened as the new parallel aid economy attracts the more skilled civil servants with higher salaries, while the remaining civil servants spend more than 50 per cent of their time dealing with a myriad of donors: negotiating, reporting, managing successive rounds of debt relief and so forth. Much of the aid delivery bypasses the national budget processes. Increasingly, aid is delivered through the non-governmental organizations (local and especially foreign). Moreover, the micromanaging of the aid process by donors and the high dependency of the recipients on this source weaken the accountability of the leaders to their own people.

31. More often, the aid/debt negotiation process bypasses the national parliaments and they are frequently expected to "approve" whatever is the outcome of the negotiations between the bureaucrats and donors. This undermines the nascent

democratic process that is beginning to take root in Africa. Finally, aid programmes are largely confined to national boundaries.

32. However, for African least developed countries, the limitation of size is real; and without economic cooperation and regional integration, it is difficult to see how they can escape the low-equilibrium growth trap. As part of the new aid relationships in the post-cold war era, these elements of the relatively ineffective aid delivery process need to be addressed so as to ensure aid effectiveness.

33. In recent years, several initiatives have been undertaken aimed at making aid more effective, resolving the debt overhang and ensuring greater transfer of real resources to the poor countries. Beside various bilateral initiatives on debt reduction, there are a few multilateral initiatives including the proposals to replenish the International Development Association (IDA) ($20.5 billion new lending to poorest countries over the period 2000-2002); replenishment of the African Development Fund ($3.4 billion); renewed efforts under the Special Programme of Assistance (SPA) for Africa to untie aid and reform the delivery mechanism; and the new enhanced HIPC Initiative launched in 1999. These are welcome developments, which could translate into increased resources for African development. Efforts should be intensified to quicken the release of the funds.

B. Private flows

34. Private financial flows (especially FDI, long-term lending and portfolio investment) remain the least exploited source of finance for Africa despite the enormous potentials that exist for them. FDI inflows to Africa since the mid-1990s have shown marginal improvements over those of the past, but remain really small. In 1998 for example, FDI worldwide rose to a record high of $644 billion, 39 per cent higher than its level of $464 billion in 1997. Of this amount, 26 per cent went to the developing countries. On the other hand, Africa's share of global FDI declined from $9.6 billion or 1.5 per cent of total FDI in 1997 to $6.6 billion or 1.3 per cent in 1998 (see table 3).

35. Within Africa, there are significant subregional and country differences. North Africa is the first choice of foreign investors and West Africa follows. However, regional aggregates mask huge national differences. In West Africa, for instance, Nigeria accounted for about 69 per cent of total inflows to Africa in 1998. By and large, the bulk of FDI in Africa is still concentrated in the extractive/mining sectors with few forward and backward linkages to the rest of the economy. However, this sector still has enormous potentials yet to be realized. Relative to the resource endowments, the share of global expenditure on research and exploration is a mere 5 per cent. A lot more can be done.

36. The above shows that FDI in the case of Africa is falling and is concentrated in the extractive sector even when available evidence indicates that returns on investment in African industry is one of the highest in the world. The reason could be that foreign private investors are generally unaware of the conditions in Africa, while some others perceive the region as risky — with a very low risk-adjusted rate of return. As regards other long-term flows, especially commercial bank loans, much of Africa is severely marginalized from the global capital markets because of the perceptions of risk.

37. A major policy issue pertains to the mechanisms to leverage FDI into sectors with the highest long-term pay-offs for African economies. The OECD countries can provide the necessary insurance and support to their firms to explore Africa's investment potentials. The case in point is the United States of America where the United States-Africa trade bill provides for the promotion of United States private investment in Africa with $650 million in loan guarantees and finance for United States investors through the Overseas Private Investment Corporation (OPIC).

38. Portfolio flows to the developing countries have almost completely bypassed much of Africa, with the exception of North Africa and the Republic of South Africa. However, given the stage of development of most African countries (33 of them are least developed countries), the extent to which they should aggressively court the potentially volatile portfolio flows remains uncertain. Experience of other developing countries in the last two decades indicates that hardly any country has attracted more than 5 per cent of GDP per annum in portfolio flows and FDI without experiencing a financial crisis at some point. Currently, African countries still have a long way to go to reach the 5 per cent benchmark. Regional pooling and development of capital markets could go a long way towards mobilizing this source of finance.

C. Export earnings

39. Finally, another potentially major source of finance from the external sector is trade. As a source of foreign exchange and investible surplus, trade has been deteriorating since the early 1980s. External trade has been beset by three interrelated problems, namely, increasing loss of market shares even in Africa's traditional exports; the perennial volatility and fall in the terms of trade; and unguarded trade liberalization which has more than doubled the growth of imports relative to exports. All these lead to worsening of the trade balance and a depletion of resources for investment. For example, in 1999, while the value of exports grew by 2.4 per cent, imports grew by 4 per cent. The terms of trade deteriorated by 1.2 per cent, 16.1 per cent and 5.8 per cent respectively for 1997, 1998 and 1999.

40. It is estimated that the terms-of-trade losses typically offset 70 per cent of ODA to Africa or about 120 per cent of the average GDP for the period 1970-1997. Furthermore, there has been a persistent loss of market shares in sub-Saharan Africa's traditional export commodities (a decline from more than 3 per cent in the 1950s to about 1.2 per cent in the late 1990s, excluding South Africa). This loss of market share in current prices in the period 1970-1997 represents a staggering annual income loss of $68 billion or 21 per cent of GDP. In comparison, the average annual net ODA inflow of about $7 billion between 1970 and 1997 is a mere fraction of the annual loss of $68 billion due to loss of market share. Put together, the losses due to terms of trade and loss of market shares far exceed all the inflows coming to Africa — ODA, FDI and private lending and portfolio flows.

41. For the African least developed countries, the losses could be substantially higher as a proportion of their GDP. This is because the aggregate includes data for oil-exporting countries which have had better terms of trade and whose loss of market shares has not been substantial. There is nothing that suggests a reversal of this trend in the medium term. For example, even though the volume of exports is increasing for many commodities, the free fall of primary commodity prices ensures that the value of exports remains constant or deteriorates. In 1998, the volume of

Africa's exports increased by 3.3 per cent but the value (in dollar terms) deteriorated by about 15 per cent.

D. Debt overhang and debt strategy (enhanced Heavily Indebted Poor Countries (HIPC) Initiative)

42. Africa's external debt overhang has intensified, and is currently estimated at $360 billion, despite various debt-relief measures (especially under the HIPC Initiative launched in 1996). In respect of almost all measures, the debt burden is worsening, with debt service as percentage of exports having averaged 30 per cent in 1999, up from 21.3 per cent in 1997. Indeed, as at 1998, Africa had spent as much on debt interest payments as on capital spending.

43. Whatever may have caused the present debt overhang, there is a broad consensus that the affected countries cannot achieve or sustain growth and development without resolving the debt crisis. Firstly, huge debt-service payment drains away fiscal resources for development. In most cases, new inflows exceed debt service but the inflows are often projectized so that quick-disbursing non-project assistance is less than debt service. Secondly, the large debt stock raises the probability of future higher taxes to service them and also raises questions about the credibility of announced reforms. Private investors are deterred as they exercise their option to wait or demand a front-loading of incentives to compensate them for risk.

44. Thirdly, many African countries have become trapped in a debt cycle whereby new lending/aid is continuously given to service existing debt stock. Such new aid shows up as "new resources" whereas it is a mere accounting adjustment without any new dollars reaching the supposed recipients. Fourthly, large debt stock entails a never-ending cycle of negotiations on debt rescheduling, reduction and new financing. This is a transactions-intensive exercise. Policy makers thus spend more time worrying about their indebtedness than designing, implementing and monitoring development programmes to benefit their citizens.

45. The HIPC Initiative launched in 1996 to address the debt burden of the poorest countries has been shown to be inadequate and ineffective. Consequently, it was revised and the enhanced HIPC Initiative was announced in autumn 1999 to remedy the shortcomings of the earlier initiative. The enhanced HIPC Initiative is expected to provide deeper, broader and faster debt relief than that available under the original initiative. Secondly, it aims to explicitly link further debt reduction to programmes of poverty reduction. It should be noted that the revised initiative represents an improvement over the previous one.

46. However, even the enhanced initiative has come under intense scrutiny. Several analysts note that the new initiative is still grossly inadequate. It circumvents the budget and does not ensure the transfer of increased resources needed to address the social needs of the population. According to the Harvard International Development Centre, neither of the HIPC initiatives has come to grips with the following three basic problems:

- The debt is owed by impoverished Governments, and therefore should be based on the HIPC Governments' capacity to pay, not on arbitrary numerical

guidelines related to exports, which have little if anything to do with the countries' fiscal position or ability to pay;

- Most HIPC Governments have no capacity to repay debts in view of the urgent social crisis confronting them. These Governments are in fact in need of large net resource transfers from the rest of the world;

- Under current arrangements, debt-service burdens are imperfectly offset via new loans, grants, rescheduling and outright arrears. The instability, unpredictability and time-consuming nature of these rollover mechanisms contribute to the incapacity of HIPC Governments and the international community to formulate long-term solutions to the pressing social crisis in the HIPC countries.

47. Thus, the fundamental challenge of a sustainable debt strategy such as the enhanced HIPC Initiative should be to re-establish the fiscal base for meeting the urgent social needs confronting HIPC countries. Evidently, there is an increasing international coalition around the strategy of outright debt cancellation as the only meaningful way to resolve the debt overhang. Some bilateral donors and non-governmental organizations have supported the idea of debt cancellation. For example, Jubilee 2000, an international non-governmental organization initiative, is completely focused on this strategy. Recently, the Secretary of the Treasury of the United States (Lawrence Summers) has lent his weight to the strategy. He articulates a compelling case for why debt relief by bilateral donors is also in the long-term interests of the creditor countries. The donor community needs to coordinate its efforts around this central strategy.

V. Towards improved domestic and external resource mobilization

48. Africa has an important opportunity for a new beginning in the new millennium. Since independence, never have the momentum and conditions for change been better — political and economic governance is improving, and the nature of Africa's problems is much better understood and appreciated. However, Africa has one major hurdle to cross — the asymmetry between the growing magnitude of its needs and the dwindling quantum of resources to address them. This was true at the beginning of the 1980s (necessitating massive structural adjustment programmes); and it was true when the United Nations Programme of Action for African Economic Recovery and Development, 1986-1990 (UNPAERD)[3] was initiated in the mid-1980s and when the United Nations New Agenda for the Development of Africa in the 1990s[4] was adopted in 1991.

49. At the beginning of the new millennium, the socio-economic situation in Africa is deteriorating (with growing poverty and ODA at its lowest in more than a decade). Besides resource requirements for poverty reduction and investment, there is a growing social and humanitarian crisis ravaging Africa which requires urgent international attention including the HIV/AIDS pandemic, malaria, tuberculosis, measles, diarrhoea and other communicable diseases — all of which are estimated to cost an additional $10 billion a year in new resources.

50. Both Africans and their development partners have a fundamental challenge in relation to the critical rethinking of the strategies pursued so far, and the initiation of

better and more effective ones. However, the problems go beyond the quantum of resources. For example, it cannot simply be assumed that the poverty-reducing growth rate of 7 per cent per annum will be automatically achieved if the estimated additional 13 per cent of GDP in investment resources is provided. There are basic problems of efficiency, leakages, absorptive capacity, and human and administrative capacity, which also need to be addressed. To be comprehensive, actions are required at the national, regional and international levels.

Domestic agenda

51. A domestic agenda would entail three major interrelated actions:

- Intensifying reforms to enable domestic economies to attract businesses so as to induce return of flight capital, attract FDI and other private inflows, and convince Africans to invest their savings at home;
- Implementing institutional and policy reforms to mobilize private savings and raise government revenue in a manner that is efficient, equitable and consistent with administrative constraints;
- Rationalizing government spending to eliminate areas of waste, and ensure efficiency in resource use.

52. An important point that needs to be emphasized is that there are major resource reserves that are unexploited in Africa simply because of lack of an enabling policy environment. The disabling factors range from anachronistic property rights and foreign ownership laws, and regulations that stifle savings and enterprise development, to weak institutions for public service delivery. Self-inflicted high transaction costs often deter private investment, domestic and foreign.

53. Besides revising regulations, there is a great deal of room for creativity in reforming, and establishing and strengthening institutions for savings mobilization. Rural and informal sector savings mobilization through microfinance institutions has potentials to be exploited.

54. Public savings through increased revenue mobilization have some promise in many African countries. In some African countries, government tax revenue is already above 25 per cent of GDP and, combined with non-tax sources, government revenue accounts for more than 30 per cent of GDP. In such countries, further reforms could focus on the efficiency and equity of the various sources rather than on the rates of taxation per se. In others, however, the tax effort is rather low. Experience of many poor developing countries shows that indirect taxes have the greatest promise (especially value-added taxes with exemptions for food; luxury excises on a few goods if the income system is weak; excises on petroleum, alcohol and tobacco; trade taxes with no quotas; and so forth).

55. Another potential permanent source of revenue for the Government is privatization of public enterprises. A possible approach is to set up a trust fund and invest the privatization proceeds in the capital market (bonds and stocks) then use the annual returns to augment government revenues in perpetuity.

56. Furthermore, countries have to devise a strategy on how to deal with flight capital. The magnitude of flight capital for many countries is such that if half should return over a 5-to-10-year period, it would more than fill in the projected residual

financing gap. Good policy environment and promise of high returns would certainly attract some of the capital back. The problem lies with the public money expropriated by government officials for personal use, which represents sizeable hidden investible reserves for many countries. Until the international community comes up with a solution for such diversion of public funds for personal use, countries should be creative in the way they pursue the matter.

57. Raising revenue is one thing; its judicious use is the other side of the coin. Under the various adjustment programmes, many countries have made significant efforts to rationalize public sector spending and ensure greater efficiency. Such reforms should be intensified. In particular, continuing efforts should be made to eliminate the areas of waste including bloated and largely unnecessary military spending, subsidies to loss-making public enterprises and so forth. Furthermore, significant public sector savings would be realized through increased private sector involvement in key sectors of the economy. Innovative approaches regarding private sector involvement in the provision of infrastructure — roads, communications, electricity and water — should be explored.

Regional approaches

58. As regards the atypically small economies of Africa (with the median economy about $2 billion in size), it is difficult to see how they can escape the low-equilibrium trap without regional and global integration. In the area of resource mobilization, regional pooling could produce important synergies and economies of scale that would enlarge the market for competition and growth, save costs and make for more efficient financial intermediation. A regional approach to the provision of public goods (roads, railways, ports, electricity-generation, early warning systems for drought, infectious disease control, centres of excellence for training and so forth) would lower costs and promote higher growth more effectively than would the sum of individual national efforts. Furthermore, increased pay-offs could result from joint security arrangements and financial sector development. Narrow national focus could negate the effectiveness of resource mobilization.

59. There are many advantages to a regional approach: it enables institutions to operate over a wider area and diversify risk; and it opens the way to greater competition and economies of scale, especially needed to spread the high fixed costs of institutions such as stock markets and banking supervision. There are limits to what can be done regionally in the presence of capital controls and without having a single currency. A common money market is not possible unless there is a common currency; institutions need to manage liquidity in the currency of their liabilities. However, there are a number of cross-border activities, that can be developed, including regional banking, bank supervision and stock markets. The basic building blocks for development of cross-border banking are improvement and harmonization in commercial and financial law, contract enforcement, accounting standards, and prudential supervision.

Meeting aid targets and making assistance work better

60. Development assistance in the past has not worked as expected (the average African was worse off in 1999 than in 1979 despite the volume of aid); but aid can

and does still work if delivered in such a way as to affect development. Studies show that with sound country management, 1 per cent of GDP in assistance translates into a 1 per cent decline in poverty and a similar decline in infant mortality. With existing allocation and a sound policy environment, development assistance serves to lift some 30 million people out of poverty per annum. Also, aid can crowd in private investment as it provides the required public services — education, infrastructure and so forth. The question is how to reverse the decline in aid and increase it substantially, while ensuring its more effective use.

61. It is encouraging to note that reforms of the aid delivery mechanisms for greater effectiveness are going forward. However, the principles that underpin the process — ownership, selectivity, participation, partnership and decentralization — need further careful development to ensure that they are anchored in the recipients' socio-political processes. Effectiveness is certainly an important element of the equation. This has been forcefully articulated in the Secretary-General's report entitled "The causes of conflict and the promotion of durable peace and sustainable development in Africa" (A/52/871-S/1998/318). The following examples are provided:

- The untying of aid and transforming the technical assistance budget for capacity-building: A key aspect of the rethinking of the delivery mechanism would be to reinstall the aid recipients in the driver's seat — to determine the development programmes to be funded by aid money. Aid would have to be completely untied to enable countries to decide their national priorities. Furthermore, the $4 billion per annum spent on foreign technical assistance could be made available to create and retain domestic African capacity. Imagine what $4 billion a year (which currently includes round trips to the donors) could do to revamp the dilapidated African universities and stem the brain drain;

- Aid for production and export diversification: The fact of continuing huge income losses due to loss of market shares and terms-of-trade losses calls for serious attention in diversifying Africa's production and export structure. General assistance therefore needs not only to increase but also to specifically target the building of production capacity and export competence.

62. However, the largely unresolved question pertains to the uncertain "quantity" of future development assistance. Can aid substantially increase, and where will the money come from? What role should external finance play in leveraging private capital inflows to Africa?

63. Three major sources of surpluses can be identified: the fiscal and growth dividend; the post-cold war peace dividend; and debt relief:

- Fiscal and growth dividend: One major reason often given for the decline in ODA is the fiscal crisis in the OECD countries. At the beginning of the 1990s, the major OECD countries were battling to tackle their fiscal problems. The problem is largely over, and most OECD countries are running fiscal surpluses. Furthermore, the outlook for growth in the OECD countries is the brightest in more than a decade. With the deficit out, and growth strong, failure to meet international pledges of resource transfers to Africa can no longer be excused on the grounds of capacity. Simply maintaining the 1980s proportion of GDP devoted to aid would immediately reverse the current free fall of aid to Africa.

Jeffrey Sachs reckons that the donors could easily come up with $10 billion a year to fight HIV/AIDS, tuberculosis and malaria in Africa and the United States share of $2 billion would cost just $8 per person per year (the cost of going to a movie). Indeed, to mobilize an additional $10 billion per year to Africa to fight diseases, develop technology and build capacity would require a mere $10 per person per year provided by the 1 billion OECD citizens;

- Post-cold war peace dividend: The cold war has been won, but there is an enormous financial peace dividend accruing to the West. For example, the United States has realized a peace dividend of about $100 billion in real terms in the last 10 years. This comes to about $10 billion per annum in real terms. If the OECD countries were to devote a mere 10 per cent of the realized peace dividend to "increasing" their transfers to Africa, the United States could be providing an additional $1 billion in grants/aid in real terms to Africa per annum. This source of funding for aid deserves serious consideration by the international community;

- Cancellation of external debt: Debt-service payment entails both domestic (budgetary) and external (balance-of-payments) resource transfers. These transfers are imperfectly offset by the new inflows, and sustainable growth cannot resume in these economies without halting the drain of resources. Full debt relief to these economies would represent a major resource transfer to them. Most dispassionate analyses of the problem recommend an unconditional write-off of the debt as the only realistic solution to the crisis. The enhanced HIPC Initiative is still inadequate and deeper debt relief can be financed by the donors;

- Provide insurance to investors and unconditional market access to African exporters: Besides providing ODA and debt relief, donors can do more to assist in resource mobilization for African development. For example, the OECD countries could provide a package of incentives to encourage their firms to locate in Africa. Such incentives could also entail allowing exporters from Africa unconditional access to the OECD markets, free of duties. This is a strategy that would have the highest pay-off in terms of transfer of real resources to African producers. The United States-Africa Trade Bill is intended to increase the volume of United States-Africa trade as well as to open United States markets to a broader range of African exports. However, to take advantage of such potential markets, the supply of African exports will need to be increased to make them more competitive;

- Institutionalize aid commitments as mandatory obligations: Finally, it is probably time for the international community to critically rethink the basis for development finance with a view to fashioning innovative approaches that, among other things, guarantee the flow of aid to deserving countries in a manner that is predictable and timely and in an amount that bears a relationship to the countries' state of underdevelopment. Clearly, the current system based on altruism has not worked well. The flows are often too arbitrary and erratic, and are delivered in such a manner as to constrain the effectiveness of such aid. One part of the innovative approaches being suggested by analysts entails translating several of the United Nations targets (for example, 0.7 per cent of GNP as aid budget) into mandatory commitments, with an institutional mechanism to collect such resources and transfer them to

the needy countries. This approach would completely overhaul the current aid process and solve the coordination problem.

VI. Conclusion

64. It should be reiterated that the proposals above are basic and can be easily implemented. There is a significant window of opportunity for both Africans and their development partners to make a difference. No doubt, Africans are deepening domestic policy reforms, with many of them already embarking on so-called second-generation reforms — democratization and institution-building; but they need resources, without which the current momentum can easily fizzle out. The only question is whether the international community can muster the political will to do something fundamentally differently for development in the new millennium. In the last few years, Denmark, the Netherlands, Norway and Sweden have shown that the aid target of 0.7 per cent of donor GNP can be met or exceeded. If others can match this positive example, resource flows for African development will take on a new dynamic.

65. A recent UNCTAD study (2000) on *Capital Flows and Growth in Africa*[5] shows that to reverse current trends in poverty levels and to achieve a 7 per cent economic growth require a doubling of foreign aid flows from the current $10 billion. Breaking the vicious circle of inadequate and unpredictable flows of financial resources to Africa would require a sustainable injection of external resources in large amounts in order to give a big push to the region so as to accelerate growth at higher levels than in the past. The price to be paid, the study argues, is a relatively small amount: $20 billion would mean an additional 5 cents for every $100 of consumer spending in the OECD countries.

66. African countries, on their part, must also act in a more responsible manner by providing an enabling policy environment that will attract private investment. They also need to strengthen the administrative capacity to improve the effectiveness of the public sector. The human resources as well as institutional and physical infrastructure capacity will also need to be developed and strengthened in African countries. The challenges for post-conflict countries in this regard are even greater and their resource requirements are enormous.

67. For all this to work, the international community must act in the spirit of true partnership, with ownership by the African countries of their development strategies as the cornerstone of this partnership.

Notes

[1] United Nations publication, Sales No. E.99.II.D.2.

[2] Ibid., part one, chap. 2, sect. A, subsect. entitled "Donors and budgets", third para.

[3] General Assembly resolution S-13/2, annex.

[4] General Assembly resolution 46/151, annex, sect. II.

[5] Geneva 2000 (UNCTAD/GDS/MDPB/7).